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INFORMATION

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A Statement on Canada's
Economic and Fiscal Outlook
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Canada

In November, I told the House of Commons Finance Committee that Canada's economic recovery was not as broadly based as we had hoped. We faced uncertainties on the international economic scene.

Today, I want to update Canada's economic and fiscal situation. Recovery has been hesitant, caused in large part by the unexpected weakness in the United States. The issue of slower-than-expected world growth and the importance of building conditions for sustained recovery was the focus of the G-7 finance ministers' meeting this Saturday.

Fiscally, our deficit targets are under pressure. Today I am announcing with the President of the Treasury Board that we intend to freeze discretionary spending on government operations and hiring effective immediately and to review all new capital projects (with the exception of health and safety and essential services), to get us closer to our target for this year.

Our pre-budget consultations have told us that many Canadians want us to continue a policy of fiscal restraint. They want to be confident that the government won't undercut the progress we have achieved in bringing down inflation and interest rates -- the foundations for lasting recovery. We believe that such action is important to keep Canada positioned for a return to strong growth by mid-year.

1. The International environment

First let me turn to the international scene.

The world economy slowed in the fourth quarter of last year, and this slower-than-expected growth is projected to continue until summer. In particular, the U.S. economy stalled in late 1991, and it now appears there will not be a significant pick-up there until late spring.

This slower growth abroad -- combined with weaker-than-expected commodity prices -- has hurt Canada's performance.

It is clear that the growth of debt in the 1980s -- public debt, business debt, household debt -- created a situation where recovery needed time to take hold and strengthen. This is especially the case in North America.

At the same time, economic performance and confidence has also been hurt by the painful process of industrial restructuring taking place in industries around the world.

Canadian companies and workers, like their counterparts in the U.S., are having to learn how to be more productive, cost-efficient and quality- and price-conscious. Recent announcements on downsizing by companies like General Motors and IBM drive this home. And while such restructuring will make us more competitive and prosperous in the next few years, it is now causing uncertainty about job prospects, and reducing economic confidence here and abroad.

2. The Canadian situation

This leads me directly to the Canadian situation. The fact is, more than any other major industrial nation, Canada's economic health is tied to that of our trading partners.

Canada exports nearly 25 per cent of all the things we grow, extract or manufacture. This accounts for about 3 million Canadian jobs. Among the G-7 industrial nations, only Germany is more heavily dependent on exports for its prosperity. By comparison, exports represent only 8.1 per cent of the U.S. economy and just 9.7 per cent of Japanese output.

But the weakness in our export markets -- especially the U.S., which buys over 75 per cent of our foreign sales -- is not the only dilemma we face. We have also imported the stagnation in U.S. economic confidence. This has added to our own domestic uncertainties.

Here, too, individuals and companies are carrying higher debt loads built up over the 1983-89 period, when Canada enjoyed the second highest growth rate among the seven major industrial powers, exceeded only by Japan. As well, Canadians are worried about employment; about our own industrial restructuring; and about taxes and government debt. And there is the overriding issue of Canadian unity.

The result of these global pressures and domestic uncertainty has been to dampen the recovery that started off so strongly in the second quarter. Third-quarter growth was in line with my November outlook. But growth in the last quarter of 1991 was essentially flat.

What does this mean for the overall prospects for 1992?

Reflecting the poorer than expected performance in the last quarter of 1991 and the first quarter of this year, the IMF has reduced its average growth forecast for all the G-7 countries to about 2 per cent for 1992.

The OECD has also reduced its forecast for the U.S. from 3.1 per cent growth to 2.2 per cent this year. And, reflecting this, it has shaved its Canadian forecast, but by a lesser amount -- from the 3.4-per-cent level I highlighted in November, to 3.1 per cent.

For the same reasons, private sector forecasters have also reduced their estimates. The private sector consensus has moved from the September view of 3.5 per cent growth in 1992 for Canada, to a current average forecast of just under 3 per cent.

On the part of our Government, we see growth picking up only slowly through the first half of the year but strengthening in the second half. Our current forecast is for growth of about 2.7 per cent in 1992.

3. Positive indicators also evident

I and every member of our Government understand the real human impact of slow growth and high unemployment. Even with Canada's social safety net, we know that behind the statistics there are harsh human consequences: fewer jobs created, persisting unemployment, as well as the anxiety about the threat of personal job loss, and personal and family hardship.

But our difficulties are no cause for despair. Our economy will pick up. There are important indicators which strongly suggest that recovery will accelerate this spring. And our policy framework is positioning Canada for substantial, sustained,

non-inflationary growth in years to come. There are good reasons for real hope in the months ahead.

This view is supported by my G-7 colleagues. As the closing communique from our meeting on Saturday plainly stated:

> "... the forces that have been inhibiting economic activity in many countries are dissipating and the conditions for improved global growth exist. Inflation expectations have eased considerably and, with the exception of some countries, wage and price pressures have been declining markedly. Long term interest rates have fallen in all countries and, in some cases, substantially. Oil prices have remained stable."

Let me highlight some of the factors that should renew public confidence in Canada's economic outlook.

- In the U.S. and Japan, there has been a sharp easing in monetary policy and interest rates. This will bolster confidence and lead to increased consumer and business spending and a return to growth in both countries. Reflecting this confidence, the U.S. stock market has reached record levels.

- At the G-7 meeting this weekend, there was agreement to intensify international co-operative efforts to improve conditions for non-inflationary growth, in turn strengthening the world economy. As the closing communique said, we "believe strongly that the appropriate framework is one of fiscal and monetary policies geared to sustainable growth with price stability over the medium term." That is the policy framework the Canadian government is adhering to.

- In Canada, interest rates have dropped significantly over the last 18 months, assisted by our policy framework of clear inflation targets, fiscal discipline and wage restraint. The commercial bank prime rate is now 7.5 per cent. That is a fall of 7¼-percentage points since May of 1990, and the lowest level since 1973. And our interest rates have also come down relative to our G-7 partners (see Chart 1).

- Mortgage rates have also fallen substantially: by 6-percentage points for one-year term mortgages. For a family carrying a $75,000 mortgage amortized over

25 years, this decline translates into a saving of over $300 a month, or about one-third of their mortgage costs (see Table 1).

- Increasing buoyancy in equity markets is allowing a growing number of companies here and abroad to replace debt with equity. This is providing a strong basis for the increased investment that creates growth and new job opportunities.

- On inflation, there has been a substantial turn-around. The year-over-year increase in the CPI this December was 3.8 per cent -- just over half of what it was last January. Even this number understates the progress we have made. For the last six months of 1991, the CPI inflation rate was 1.7 per cent on an annualized basis, compared to 4.5 per cent for the comparable period in 1990. By comparison, U.S. inflation over the same six-month period in 1991 was 2.8 per cent. And when this January's numbers come out, we expect to see Canadian year-over-year inflation under 2 per cent.

- Wage settlements also show that inflationary pressures are coming down. For last October-November combined, public sector settlements averaged 2.2 per cent, against an average of 6.4 per cent in the first quarter. And private sector settlements had fallen to 3.3 per cent, well below their first-quarter mark of 5.3 per cent.

- Finally, with our improved inflation performance -- and, in turn, as confidence grows that our targets for reduced inflation in 1992 and beyond will be met -- we are setting the essential monetary basis for sustained low interest rates promoting economic recovery. Low interest rates are fully consistent with our policy framework, which saw rates rise as inflation pressures in Canada rose. Now with inflation pressures and inflation expectations on the decrease, we are in a position where monetary conditions can encourage spending in the economy without jeopardizing our ability to meet our inflation targets.

Each of these factors represents important progress in putting in place a strong foundation for renewed confidence, competitiveness and sustained growth.

Even with their revisions in economic forecasts, the OECD expects Canada to record the strongest growth in output this year among the G-7 countries and all 24 OECD nations. We are projecting that Canada will have a strong rate of job creation this year, although the unemployment rate will be slow to come down.

These positive factors are beginning to produce results. Lower mortgage rates and the easing in inflation and new house prices have improved housing affordability to one of the best levels in the last 10 years. This improvement is the major reason for a near doubling in housing starts since the beginning of 1991 (see Chart 2).

We expect consumer spending to also respond to lower interest rates in the near-term, with the result that growth will pick up in the second quarter. Lower rates will also help the business sector improve their balance sheets through debt restructuring and new equity issues. Cash flow will improve, boosting the ability to invest and create job opportunities.

4. The fiscal outlook

While I am confident that we are on the right course, the current slow pace of recovery remains a real concern. This includes the implications it has for our fiscal performance in 1991-92.

As I said in my November statement to the Parliamentary Standing Committee on Finance, we expected a deterioration in our deficit track during the first half of this current fiscal year -- due to the recession, and also reflecting the start-up of the GST. But we also looked for a substantial improvement in the second half, due to the expenditure control measures we introduced in the budget, the impact of lower interest rates, and the resumption of economic growth.

While some improvement has recently taken place, it is not enough to compensate for the shortfall in revenues produced by weaker-than-expected real growth and better-than-projected inflation.

This weakened fiscal position has put pressure on the government's financial requirements. The government has now reached the limit of its borrowing authority for

the current fiscal year and, as has been the case when this occurred in the past, will pursue the balance of its borrowing program under the authority of section 47 of the Financial Administration Act.

Canada is not alone in facing fiscal pressure. According to recent IMF and OECD forecasts -- and confirmed at our Saturday G-7 meeting -- almost all G-7 countries will have a worse fiscal outcome this year than they had earlier projected.

We are not prepared to accept a deterioration in our fiscal situation without taking steps to stay close to our deficit track. We have, in the course of this year, taken a number of internal actions to offset some of these pressures. Also, we have reviewed a broad range of our current operations and spending to find further ways to keep as close as possible to the deficit track. And it was necessary to increase Unemployment Insurance premiums as well.

Today, the President of the Treasury Board and I are announcing further action in the form of a freeze on discretionary operating spending and new hiring by federal departments for the remainder of the 1991-92 fiscal year. We are also reviewing all new capital projects and will proceed only with those required for reasons of health, safety or essential services.

With these actions, I am aiming to keep the deficit for this fiscal year below \$31½ billion.

The management actions we are announcing today build on the wide-ranging restraint measures we have already undertaken.

- We passed legislation freezing public service and Parliamentary salaries this year, and severely limiting increases next year.

- We are implementing a 10-per-cent cut in the number of senior managers in the public service.

- We held program spending growth in 1990-91 to 3.4 per cent -- a level lower than forecast -- despite the recession.

- And despite the continuing economic weakness, we have been able to hold the growth of federal program spending this year within the limits set out in last February's budget and contained in our draft Spending Control Act.

It is because we have been willing to take tough action on spending that Canada's fiscal record has been better than that of the U.S. federal government. In 1984-85, the Canadian deficit, on a comparable accounting basis, was 6.7 per cent of our economic output, compared to 5.3 per cent for the U.S. We have turned this around, so that by last year, our financial requirements were 3.7 per cent of GDP, against 4.8 per cent for the U.S. government.

Even more important, we have been able to control our deficit in the face of economic weakness to a much greater degree. This fiscal year, we expect our financial requirements as a percentage of GDP to be roughly unchanged from 1990-91, while those of the U.S. are expected to surge further, to over 6 per cent of GDP.

5. The 1992-93 budget

Continuing action to ensure that the deficit comes down is essential to build the confidence and bolster the basic conditions -- price stability and lower interest rates -- for recovery and durable growth.

However, the pressures on government revenues experienced this year will continue through 1992-93. This will more than offset the dividend we will receive in terms of lower interest payments on the public debt due to lower interest rates.

This means, frankly, that it will be extremely difficult to hit the objective of a 1992-93 deficit below $25 billion set out in last year's budget. But we will bring the 1992-93 deficit in substantially below the 1991-92 outcome.

And it is in this context that we will be planning the 1992 budget. This budget will further our plan of putting in place the ingredients for sustained growth in jobs and output. Together with the easing in monetary conditions, it will aim to bolster confidence in the economy.

As part of our planning process, I have recently concluded extensive pre-budget consultations with groups from all segments of Canadian society and regions of the country.

Most Canadians realize that deficits and debt have undermined our economic health and competitiveness. The message they are sending us is blunt: we have to live within our means; government at all levels must learn to do the same.

Our consultations also underlined that Canadians want deficit reduction to take place through spending control, not through tax increases. There is widespread conviction that the current tax burden is too high, and additional taxation would further dampen recovery, hurt our ability to sell products and services abroad, and encourage firms to invest and create jobs somewhere else.

I also heard deep concern about our ability to sustain the national social programs that are an established part of the Canadian fabric.

Canadians value the social safety net we have worked together to build. And they feel that education and training should be a national priority to strengthen our competitive ability in a world of fast-changing technology.

At the same time, we heard that many Canadians are becoming increasingly worried about the rising cost of these programs, and our ability to sustain them indefinitely. There was widespread concern that such activities are not operating as efficiently as they could, and are not being managed with an eye on obtaining maximum value for the taxpayer's investment.

Value-for-money was also an important factor in assessing government performance. There was a widespread feeling that the effects of globalizing, restructuring and streamlining must extend beyond business to government itself. Government must become more efficient, more cost-conscious, and more committed to providing taxpayers with quality and satisfactory services.

Above all, our consultations have re-assured me that Canadians are ready for -- in fact, want -- constructive change in many areas of national and economic life.

They understand that the world in which Canada exists -- the problems and opportunities we must manage -- are very different from even 10 years ago. They know there is no way Canada can insulate itself from events beyond our borders or isolate itself from the world. They recognize that the best -- in fact, the only -- way to achieve prosperity is to actively and progressively improve our national ability to compete, to invest, and to adapt to new market needs and opportunities.

Finally, our consultations also found universal agreement that to ensure Canada's future prosperity, all levels of government and all sectors of society must place new emphasis on co-operation, mutual consultation and new forms of partnership. People are telling us loud and clear that Canadians can no longer afford the luxury of confrontation.

I think we took a large step forward at the finance ministers' and First Ministers' meetings that were held last month. If we can continue to meet in a way that emphasizes a shared approach to national and regional challenges, and a balanced perspective on short-term needs and long-term opportunities, there will be further reason for national confidence.

In conclusion, Canada's potential for growth is strong. And we are working to identify the further actions that will reinforce this growth. Our federal-provincial meetings, the pre-budget consultations and the G-7 meeting on Saturday have all provided important insights that will help produce an upcoming budget that does its part to build the foundations for renewed confidence, stronger recovery and sustained economic growth.

Chart 1

Three-month eurocurrency deposit rates in the G7 countries

per cent – as of January 17, 1992

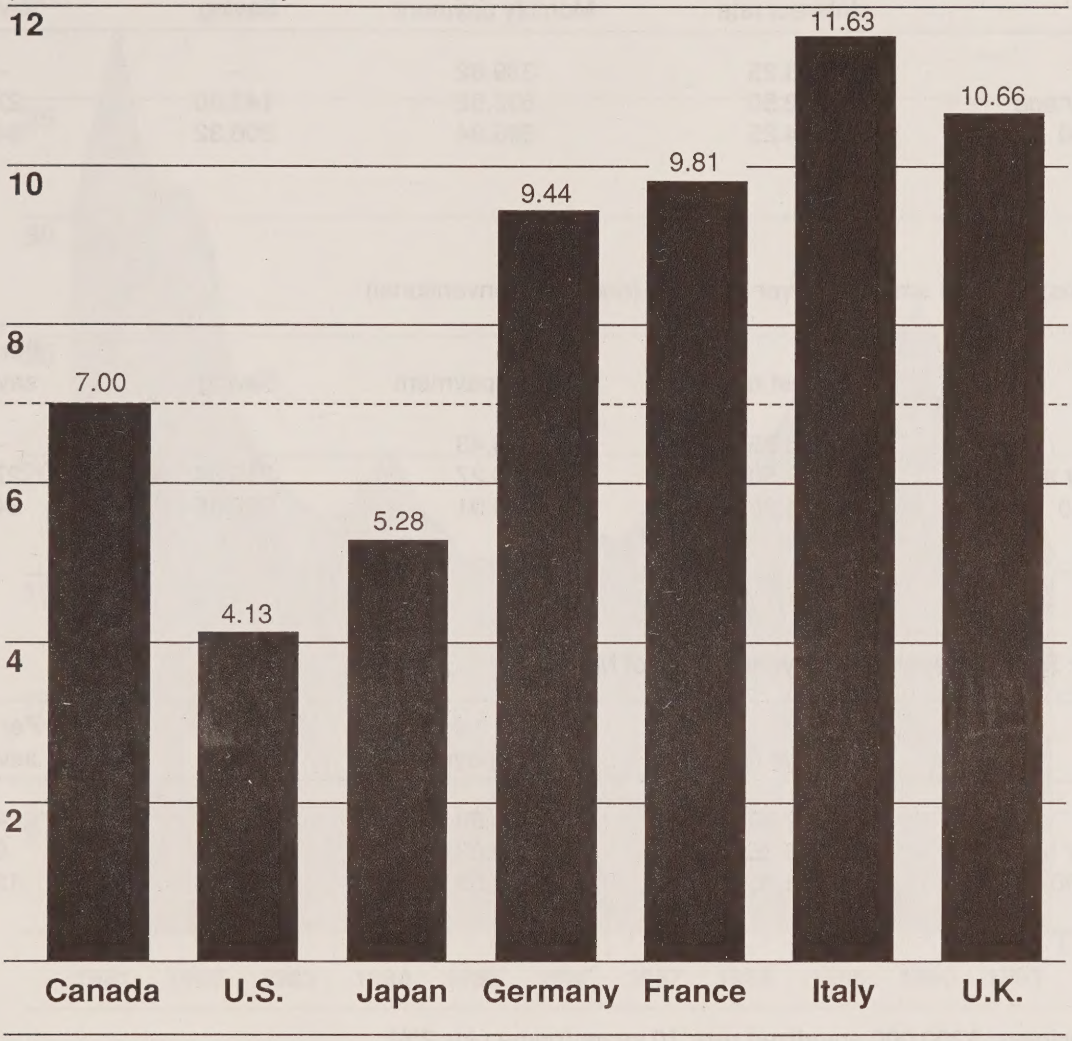

Table 1

The impact of lower interest rates on mortgage, consumer and business loans

Mortgages: $50,000 amortized over 25 years (one year conventional)

	Interest rate	Monthly payment	Saving	Per cent savings
Today	8.25	389.62	–	–
One year ago	12.50	533.52	143.90	27.0
May 1990	14.25	595.94	206.32	34.6

Mortgages: $75,000 amortized over 25 years (one year conventional)

	Interest rate	Monthly payment	Saving	Per cent savings
Today	8.25	584.43	–	–
One year ago	12.50	800.27	215.84	27.0
May 1990	14.25	893.91	309.48	34.6

Car loan: $20,000 repaid over 5 years (Bank of Montreal)

	Interest rate	Monthly payment	Saving	Per cent savings
Today	12.00	444.89	–	–
One year ago	16.25	489.03	44.14	9.0
June 1990	18.25	510.59	65.70	12.9

Small business: $200,000 amortized over 10 years (prime plus 2%)

	Interest rate	Monthly payment	Saving	Per cent savings
Today	9.50	2,587.95	–	–
One year ago	14.75	3,196.15	608.20	23.5
May 1990	16.75	3,444.34	856.39	33.1

Chart 2
Housing affordability
(monthly payments as a share of disposable income)